

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
LUBBOCK DIVISION

IN RE:	§	
	§	
AMERICAN COTTON SUPPLIERS	§	CASE NO. 02-50003-7
INTERNATIONAL, INC.,	§	
	§	
Alleged Debtor	§	

IN RE:	§	
	§	
BILLIE WAYNE SPRADLING JR.,	§	CASE NO. 02-50004-7
	§	
Alleged Debtor	§	

IN RE:	§	
	§	
CHARLES L. SPRADLING,	§	CASE NO. 02-50005-7
	§	
Alleged Debtor	§	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Compagnie Cotonniere Inc. (“Copaco”), the sole petitioning creditor, brought these involuntary petitions against American Cotton Suppliers International Inc. (“ACSI”), Billie Wayne Spradling Jr., and Charles L Spradling (collectively “Alleged Debtors”), asserting a claim of \$7.7 million against each Alleged Debtor. Copaco’s claims arise out of the failed ACSI/Copaco Joint Venture (“Joint Venture”) between Copaco and ACSI.

Trial of these involuntaries was held May 21, 2002 to May 24, 2002 and June 4, 2002 to June 7, 2002, after which the court took the matter under advisement. While pending under advisement, the parties requested that the court hold off on issuing its decision as they were engaged in settlement

negotiations. After a few weeks, the court was advised that the parties had been unable to settle and they requested that the court proceed with issuance of its ruling on the case. The court, therefore, submits the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. Copaco is a corporation organized and existing under the laws of the State of Delaware with its principal place of business located in Lubbock County, Texas. It is wholly owned by Compagnie Cotonniere S.A., a French limited company.

2. ACSI is a corporation organized and existing under the laws of the State of Texas with its principal place of business located in Lubbock County, Texas. It was formed by Billie Wayne Spradling Jr. and his brother, Charles Spradling, to serve as a joint venturer in a joint venture with Copaco. The Spradlings (Billie Wayne Jr. and Charles) were the sole initial shareholders of ACSI.

3. Billie Wayne Spradling Jr. is an individual who resides in the City of Lubbock, Lubbock County, Texas, and is the Vice President of ACSI.

4. Charles Spradling is an individual who resides in the City of Simpsonville, South Carolina, and is the President of ACSI.

5. On November 5, 1992, Copaco and ACSI signed the Amended Joint Venture Agreement, thereby forming the ACSI/Copaco Joint Venture, created as a vehicle to engage in the buying and selling of cotton. This Agreement set forth the respective duties and responsibilities of the parties as related to the business venture and basically provided that Copaco would provide the financing for the venture and ACSI would provide the management, expertise and personnel to conduct its operations.

6. The Amended Joint Venture Agreement states that “Copaco’s obligation to fund this Venture shall not exceed the aggregate of FOURTEEN MILLION AND NO/100'S DOLLARS (\$14,000,000.00) (U.S. Dollars) in funding for cash, margin and expenses, and shall be subject to Copaco’s obtaining suitable bank financing for funding after December 31, 1992. However, Copaco reserves the right to continue funding without bank financing pursuant to this agreement if it desires to do so without causing termination of this Agreement.” In order to provide the financing for the operations of the Joint Venture, Copaco borrowed funds from its parent company, Compagnie Cotonniere, S.A., which in turn obtained financing from French banks.

7. Under the Joint Venture Agreement, Copaco was not only a partner in the Joint Venture but also a creditor of the Joint Venture to the extent of its financing.

8. Section 3.08 of the Amended Joint Venture Agreement provides that “[I]n the event the Venture shall have incurred a net loss on the aggregate of all the Transactions entered into on or before the final transaction date, each party shall be charged with 50% of such loss. In order to secure ACSI’s potential liability for losses, Billie Wayne Spradling Jr. and Charles Spradling agree to personally guarantee such loss sharing described herein by executing the personal guarantee attached hereto as Exhibit ‘C’.”

9. Billie Wayne Spradling Jr. and Charles Spradling both executed the “Guaranty” attached as Exhibit “C” to the Amended Joint Venture Agreement that reads as follows: “That, Billie Wayne Spradling Jr. and Charles Spradling, jointly and severally do hereby guarantee payment of any obligations of American Cotton Suppliers International, Inc., described in Section 3.08 “Loss Sharing” of the Amended Joint Venture Agreement.”

10. Though the Joint Venture Agreement provided that ACSI would exercise control over cotton trades and management of the Joint Venture, Copaco was allowed an on-site representative of its interests. Initially this representative was Larry LaTouf, an employee of Compagnie Cotonniere S.A. who had initiated discussions on behalf of Compagnie Cotonniere S.A. with the Spradlings regarding the formation of a business venture. LaTouf was present on the premises of the Joint Venture from the very beginning. In addition to his salary from Compagnie Cotonniere S.A., LaTouf received a 10% share of Copaco's profit from the Joint Venture. This arrangement continued until January 1, 1996, when LaTouf resigned from Compagnie Cotonniere S.A. However, LaTouf continued thereafter to represent Copaco in the Joint Venture.

11. In April, 1994, the Joint Venture paid \$100,000 to World Bridge Trading at LaTouf's insistence. Billie Wayne Spradling Jr. testified that LaTouf threatened to have financing pulled if the payment was not made. Around this same time, LaTouf was granted a one-third ownership in ACSI which he obtained, again according to Billie Wayne Spradling Jr.'s testimony, by threat of pulling the Joint Venture financing.

12. Upon his January 1, 1996 resignation from Compagnie Cotonniere S.A., LaTouf (through his company, LaTouf Enterprises, Inc.) contracted with Copaco and Compagnie Cotonniere, S.A. to provide management for Copaco's interest in the Joint Venture, in exchange for a one-third share of Copaco's profits from the Joint Venture. This arrangement continued until April 20, 1998, at which time LaTouf permanently left the Joint Venture for Paris where, on April 27, 1998, he was rehired by Compagnie Cotonniere S.A. in an executive management position. LaTouf ceased all employment with Compagnie Cotonniere S.A. on July 31, 1999.

13. From Copaco's incorporation to LaTouf's January 1, 1996, resignation, LaTouf served as a director, vice president, and secretary of Copaco, and continued to be listed in these capacities until May 30, 2001, well after his resignation.

14. On May 9, 1995, the shareholders of ACSI voted LaTouf chairman of ACSI's board. The Spradlings testified that LaTouf took over control of the Joint Venture, and that he made all management, cotton trading, and futures decisions. LaTouf resigned his position as chairman of ACSI's board on April 20, 1998. LaTouf continues to be a one-third shareholder of ACSI.

15. The Joint Venture was successful and made money for its partners between 1992 and 1995. However, in 1996 the Joint Venture began losing large sums of money and by the end of the year the financial statements of the Joint Venture showed a net loss for the year totaling \$2.8 million.

16. The Joint Venture continued losing money in 1997 and 1998, and according to the audited financial statements of the ACSI/Copaco, J.V. prepared by D. Williams & Co., the Joint Venture incurred a net loss of \$6,667,746 for the year ended December 31, 1998. As of that date, the Joint Venture's current liabilities exceeded its total assets by \$8,751,310.

17. At the end of 1998, the Joint Venture had borrowed from Copaco the maximum amount set forth under the terms of the Amended Joint Venture Agreement of \$14 million. In addition, the Joint Venture owed Norwest Bank Texas, N.A. and U.S. Bancorp Ag Credit, Inc. \$9.8 million each, and was out of compliance with certain loan covenants related to its net worth and available working capital required by its lending agreements with these financial institutions. The banks notified the Joint Venture that they would not extend their loan maturity dates past March 15, 1999.

18. The banks demanded \$1 million of additional collateral before they would extend the maturity dates and continue funding. On March 15, 1999, Copaco deposited \$1 million with the banks as security for the loans, thereby increasing Copaco's total funding of the Joint Venture to \$15 million. The Joint Venture soon found itself out of compliance on its notes from the banks again, and the banks ceased funding in July, 1999. The banks redeemed Copaco's \$1 million deposit against the Joint Venture's debt.

19. On May 27, 1999, Copaco, ACSI and the Spradlings executed a Memorandum of Understanding relating to the Amended Joint Venture Agreement. Pursuant to the terms of the memorandum, Billie Wayne Spradling Sr., Billie Wayne Spradling Jr. and Charles Spradling agreed to execute a non-competition agreement in favor of the Joint Venture; ACSI agreed to pledge its customer-base to secure the debts of the Joint Venture; and the Spradlings agreed to mortgage the building located at 1508 Texas Avenue in Lubbock, Texas, to secure their indebtedness associated with the Joint Venture. In exchange, Copaco, on the condition that ACSI would do the same, agreed to deposit the sum of \$969,782 – representing its portion of undue draws according to the audited financial statements of December 31, 1997 – in an escrow account, and to allow each of the Spradlings to receive guaranteed draws of \$7,000 each for living expenses.

20. According to the audited financial statements prepared by D. Williams & Co. for the year ended December 31, 1999, the Joint Venture incurred another net loss of \$4,201,099 (including extraordinary loss of \$2,777,964) for the year, and its current liabilities exceeded its total assets by \$12,952,409.

21. Through the latter half of 1999 and beginning of 2000, the Joint Venture was effectively without financing: Copaco had advanced the maximum that it was obligated to advance and the banks had ceased their financing. The Joint Venture lost significant sums of money during this time, as well as opportunities to make sizeable profits. Nevertheless, in 2000, Copaco loaned the Joint Venture an additional \$1.64 million pursuant to an undated Memorandum of Understanding between ACSI and Copaco whereby both parties sought to clarify their relationship and concerns in order to facilitate future cooperation. However, because of market conditions and the inability to obtain further financing, ACSI and Copaco agreed on June 30, 2000, to terminate the Joint Venture as of July 31, 2000.

22. On June 1, 1999, Billie Wayne Spradling Sr. transferred the building located at 1508 Texas Avenue to Charles Spradling.

23. Despite already having transferred the building out of his name, on July 22, 1999, Billie Wayne Spradling Sr. sent a letter to Copaco agreeing to grant Copaco a first lien mortgage against the building at 1508 Texas Avenue to secure the repayment of the indebtedness of the Joint Venture to Copaco.

24. According to the Partnership Tax Return filed with the Internal Revenue Service for calendar year 2000, the Joint Venture lost \$2,160,536. The capital accounts reflected in the return show a negative \$7,422,417 for Copaco and a negative \$7,742,439 for ACSI, the difference of \$320,024 constituting the unauthorized draws and guaranteed payments received by the Spradlings.

25. Upon termination and windup of the Joint Venture, and according to professional auditing and income tax filings, the Joint Venture lost a total of \$15,164,856, all advanced by Copaco. Copaco brought these involuntaries, asserting its right to payment under the loss sharing clause of the

Joint Venture agreement for \$7,742,439 from ACSI, and from Billie Wayne Spradling Jr. and Charles Spradling as guarantors.

26. In March 2001, officials of Copaco traveled to Lubbock, Texas, in an effort to meet with the Spradlings about the status of the unpaid bills of the Joint Venture, and arrange for a repayment agreement with ACSI, Billie Wayne Spradling Jr. and Charles Spradling. The negotiations were unsuccessful. The Spradlings told the Copaco officials that they could not and would not repay Copaco because of certain asserted offsets and credits they alleged were owed by Copaco to ACSI.

27. Billie Wayne Spradling Sr., Charles Spradling and Billie Wayne Spradling Jr. created a new cotton trading business that operated under the same assumed name as ACSI, that is, AMCOT, Inc. d/b/a “ACSI-II”. ACSI-II operates using the same building located at 1508 Texas Avenue, uses the same customers and suppliers of cotton as ACSI, employs many of the same employees, and holds itself out as a cotton merchant, agent, broker and exporter – just as ACSI did. ACSI-II presently uses the same logo as ACSI and its officers are advertised to be Billie Wayne Spradling Sr., Chairman, Billie Wayne Spradling Jr., President/Manager, and Charles Spradling, Vice President.

28. “ACSI-II” is an assumed name of AMCOT, Inc.; it was reinstated as a corporation on December 28, 2000, and Billie Wayne Spradling Jr. became its registered agent at 1508 Texas Avenue, Lubbock, Texas, on June 28, 2001.

29. The note from Billie Wayne Spradling Jr. that was given to Emory Cassell for the purchase of the AMCOT, Inc. stock, dated January 25, 2001, in the principal amount of \$75,000, provides for annual “interest only” payments for a period of ten years, followed by a large balloon payment, and is secured with the “stock” of ACSI-II. Although Billie Wayne Spradling Jr. has made

none of the payments called for under the note to Cassell and the conversion of ACSI-II to a limited liability partnership violates the terms of their security agreement, Cassell has made no effort to collect the debt or foreclose the security interest, and Billie Wayne Spradling Jr. has stated that he owes Cassell, "Nothing."

30. The Joint Venture had at least eight separate trade creditors that were owed more than \$38,000 that were not paid during the winding up period.

31. There is a series of transfers between Spradling & Sons, Inc., Billie Wayne Spradling Sr. and Charles Spradling between January 29, 1999, and January 26, 2001, involving the property located at 1508 Texas Avenue. These transactions were all made without consideration, and after having received notice of impending federal tax liens.

32. After filing the final tax return and evaluating the legal alternatives available to it, Copaco decided to file involuntary bankruptcy petitions against ACSI and its principals. In November 2001, representatives of Copaco contacted other creditors about joining in the involuntary petition. S & L Brokerage, Inc. at first indicated that it would be willing to join in such a petition, which was prepared and sent to its attorney for signature. A short time later, however, officials of Copaco learned that S & L Brokerage had, abruptly, been paid. Representatives of Copaco also contacted C.L. Wong, agent of Cheng Yuan Trading Company, which was owed in excess of \$500,000 by the Joint Venture representing the unpaid balance of a \$1 million promissory note. C.L. Wong declined to have Cheng Yuan join in the petition against ACSI because the Spradlings had purportedly promised to pay Cheng Yuan half of what was owed in the spring of 2002 and the balance in the spring of 2003.

33. On January 2, 2002, Copaco filed the three involuntary petitions which are the subject of these bankruptcy cases against ACSI, Billie Wayne Spradling Jr. and Charles Spradling.

34. Following the filing of the involuntary petitions, ACSI-II was converted to a limited liability partnership, with Algedon, L.L.C. as its general partner, and Billie Wayne Spradling Jr. owning all of the interest of Algedon.

35. To avoid offsets by the Bank, Billie Wayne Spradling Jr. stopped operating the business of ACSI-II out of the AMCOT checking account, and instead began operating the business out of a 'trust account' under his own name. Both the now inactive ACSI-II account and the 'trust account' reflect large transfers to personal creditors of the Spradlings, as well as large, unexplained cash withdrawals, one \$18,000 transfer to "Andersons Jewelers," and numerous unexplained transfers to Spradling insiders, including payments to Billie Wayne Spradling Sr. in excess of \$50,000 marked "repay loans" and numerous large transfers to a life insurance trust for Kelsey Dee Spradling, Billie Wayne Spradling Jr.'s daughter.

36. In addition to the unpaid note to Cassell and the debt owed to Copaco under the guaranty, Billie Wayne Spradling Jr. is liable for the obligations of ACSI under the Joint Venture agreement and guaranty, including debts owed to Cheng Yuan in the approximate amounts of \$518,547, \$21,167, and \$3,877.08 respectively. He is also liable to Spradling Group, Inc. on a series of unpaid insider/shareholder loans, and owes approximately \$180,000 to his ex-wife pursuant to the property settlement in his divorce. (He claims he owes her nothing.) For 2001, ACSI-II had a net profit of \$1.3 million. It was a Subchapter S corporation in 2001, but Billie Wayne Spradling Jr. has

made no payments for any estimated tax liability. As of the time of trial, he had yet to file his 2001 income tax return.

37. In their negotiations with the Internal Revenue Service, both Charles and Billie Wayne Spradling Jr. made affirmative representations of multi-million dollar obligations to Copaco. This enabled them to procure favorable tax settlements with the IRS. In the same statement to the IRS, Billie Wayne Spradling Jr. swore that the debt to his ex-wife was actually \$250,000 – \$70,000 more than the amount reflected in his divorce decree.

38. While the involuntary petitions have been awaiting adjudication, the building located at 1508 Texas Avenue, Lubbock, Texas, has been placed up for sale and an earnest money contract entered into with a prospective purchaser.

39. If appropriate, these findings of fact shall be considered conclusions of law.

CONCLUSIONS OF LAW

40. The court has jurisdiction over this matter under 28 U.S.C. § 1334(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(1).

41. Under section 303(b) of the Bankruptcy Code, an involuntary petition may be commenced:

(1) by three or more entities each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least [\$11,625] more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;

(2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547,

548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least [\$11,625] of such claims.

11 U.S.C. § 303(b)(2000).¹ Thus, section 303(b) provides the standing requirements for a petitioning creditor.

42. A sole petitioning creditor may have standing to successfully prosecute an involuntary case. *See id.* § 303(b)(2); *In re Moss*, 249 B.R. 411, 419 (Bankr. N.D. Tex. 2000). In this context, section 303(b)(2) must be read in conjunction with section 303(b)(1); paragraph (b)(1) defines the type of claim that the sole petitioning creditor must hold.

43. The parties agree that each of the Alleged Debtors had fewer than twelve creditors on the date the involuntary petitions were filed. *See* Pretrial Order.

44. The court may not order relief against Alleged Debtors, if Copaco's claim is either contingent as to liability or is the subject of a bona fide dispute. *See* 11 U.S.C. § 303(b)(1); *In re Biogenetic Techs. Inc.*, 248 B.R. at 855-56 (Bankr. M.D. Fla. 1999).

45. Section 303(h) directs the court to order relief if "the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute." 11 U.S.C. § 303(h)(1).

Whether Copaco's Claims are Contingent as to Liability

46. "A claim is contingent as to liability if the debtor's legal duty to pay does not come into existence until triggered by the occurrence of a future event and such future occurrence was within the

¹The United States Code actually provides that the unsecured claim must total at least \$10,000. However, this amount is adjusted for inflation. The current amount, as modified by section 104, is \$11,625. 11 U.S.C. § 104 (Supp. 2002).

actual or presumed contemplation of the parties at the time the original relationship of the parties was created.” *Subway Equip. Leasing Corp. v. Sims (In the Matter of Sims)*, 994 F.2d 210, 220 (5th Cir. 1993), *quoting In re All Media Props. Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff’d* 646 F.2d 193 (5th Cir. 1981). “When the duty to pay a claim does not rest upon the occurrence of a future event, the claim is not contingent.” *In the Matter of Sims*, 994 F.2d at 220. Whether a claim is contingent as to liability is decided as of the date of filing of the involuntary petition. *See In the Matter of Smith*, 243 B.R. 169, 179 (Bankr. N.D. Ga. 1999).

47. With respect to the liability of Billie Wayne Spradling Jr. and Charles Spradling, Texas law recognizes a distinction between guarantees of payment and guarantees of collection. *See Cox v. Lerman*, 949 S.W.2d 527, 530 (Tex. App. – Houston [14th Dist.] 1997, no writ); *Ford v. Darwin*, 767 S.W.2d 851, 854 (Tex. App. – Dallas 1989, writ denied). “[A] guaranty of payment is an obligation to pay the debt when due if the debtor does not.” *Ford*, 767 S.W.2d at 854. A guarantor of payment is primarily liable and waives any requirement that the creditor must first take action against the debtor as a condition precedent to the guarantor’s liability. *See Cox*, 949 S.W.2d at 530; *Ford*, 767 S.W.2d at 854. “A guaranty of payment thus requires no condition precedent to its enforcement against the guarantor other than a default by the principal debtor.” *Cox*, 949 S.W.2d at 530. The creditor may bring an action against a guarantor of payment without first initiating any action against the debtor. *See Hopkins v. First Nat’l Bank at Brownsville*, 551 S.W.2d 343, 345 (Tex. 1977)(per curiam).

48. The guarantees signed by Billie Wayne Spradling Jr. and Charles Spradling state that each of them “jointly and severally do hereby *guarantee payment* of any obligations of American

Cotton Suppliers International, Inc., described in § 3.08 ‘Loss Sharing’ of the Amended Joint Venture Agreement.” (emphasis added). The inclusion of the phrase ‘guarantee payment’ in the guarantees, and prior Texas precedent, compel the conclusion that the guarantees signed by Billie Wayne Spradling Jr. and Charles Spradling are guarantees of payment. See *Universal Metals & Mach. Inc. v. Bohart*, 539 S.W.2d 874, 866-67 (Tex. 1976) (language whereby guarantor “guarantee(s) the prompt payment of principal and interest” held to be guarantee of payment); *Ford*, 767 S.W.2d at 855 (holding that guarantor of payment on nonnegotiable instrument is treated the same as a guarantor of payment on a negotiable instrument). Because the guarantees signed by Billie Wayne Spradling Jr. and Charles Spradling are guarantees of payment, the only condition precedent to their liability is ACSI’s default. See, e.g., *Cox*, 949 S.W.2d at 530. Accordingly, if ACSI’s liability to Copaco became fixed before the filing of these petitions, meaning that ACSI defaulted on its obligation to Copaco, Billie Wayne Spradling Jr.’s and Charles Spradling’s liability to Copaco likewise became fixed prior to the date of filing on account of ACSI’s default.

49. A joint venture is subject to the same laws of conduct and termination as are partnerships in general. See *Austin v. Truly*, 721 S.W.2d 913, 922 (Tex. App. – Beaumont 1986), *aff’d sub nom. Truly v. Austin*, 744 S.W.2d 934 (Tex. 1988); *Rice v. Lambert*, 408 S.W.2d 287, 291-92 (Tex. Civ. App. – Corpus Christi 1966, no writ). Upon the winding up and liquidation of a partnership, Texas law dictates that the partnership’s assets must be applied to the obligations of the partnership before a final distribution of property or allocation of loss can be made between the partners themselves. See TEX. REV. CIV. STAT. ANN. art. 6132b-8.06(a) (Vernon Supp. 2002); *Rice*

v. Lambert, 408 S.W.2d 287, 291 (Tex. Civ. App. – Corpus Christi 1966, no writ); *Hines v. Dean*, 1 White & W 379, 1878 WL 8820 (Tex. Ct. App. 1878).²

50. Texas law permits a partner to make loans to the partnership. *See* TEX. REV. CIV. STAT. ANN. art. 6132b-4.01(k); *King v. Evans*, 791 S.W.2d 531, 533 (Tex. App. – San Antonio 1990, no writ). Such partner becomes a creditor of the partnership. *See King*, 791 S.W.2d at 533. A partner that has loaned funds to the partnership “has the same rights and obligations with respect to that matter as a person who is not a partner.” TEX. REV. CIV. STAT. ANN. art. 6132b-4.01(k).

51. “In winding up the partnership business, the property of the partnership . . . must be applied to discharge its obligations to creditors, including . . . partners who are creditors other than in their capacities as partners.” *Id.* art. 6132b-8.06(a). Thus, creditor-partners are treated the same as other creditors. *See id.* Alleged Debtors’ argue that Texas law makes the claim of a creditor-partner contingent on a final winding-up and accounting. This is incorrect. The statute merely mandates that the partnership’s assets must be used to satisfy the claims of creditors and that a creditor-partner is to be treated like any other creditor of the partnership.³ The liability of the partnership to a creditor-partner is not contingent on a final winding-up and accounting of the partnership’s assets.

52. While Texas law does not require a complete liquidation of assets and accounting before a partnership becomes liable to a partner-creditor, the partnership agreement may so provide. *See* TEX. REV. CIV. STAT. ANN. art. 6132b-1.03(a). The Joint Venture Agreement provides that “[i]n

²Texas law controls all non-bankruptcy issues in this case.

³Alleged Debtors conceded at trial that Copaco is a creditor of the Joint Venture, i.e. Copaco’s funding of the Joint Venture constituted loans and not capital contributions in the ordinary partnership sense.

the event the Venture shall have incurred a net loss on the aggregate of all the Transactions entered into on or before the final transaction date, each party shall be charged with 50% of such loss.” The phrase ‘in the event’ creates contingent liability – liability will not become fixed until the event contemplated occurs. The event so contemplated is a net loss on the aggregate of all transactions entered into on or before the final transaction date. The Joint Venture Agreement defines ‘net loss’ as “net losses of the Venture as determined by generally accepted accounting principals [sic].” The Joint Venture Agreement further defines ‘final transaction date’ as “the Collection Date on any Transaction entered into by the Venture on which the Venture has not received the Collection price upon an event of termination.”

53. An event of termination occurred on June 30, 2000, when the parties mutually agreed to terminate the Joint Venture as of July 31, 2000. The parties presented no direct evidence as to what date constituted the ‘final transaction date.’ However, the parties testified that the Joint Venture entered into no transactions after the summer of 2000, at the latest. The parties further testified that performance on transactions was due up to one year from the date of the transaction. Thus, the latest collection date on the Joint Venture’s final transaction, that being the date that payment is due after performance of the Joint Venture’s last transaction, was sometime in the summer of 2001 – at the latest. The collection date of the Joint Venture’s final transaction passed well before the filing of these involuntaries. Thus, if during the summer of 2001, the Joint Venture suffered a net loss on the aggregate of all transactions as calculated according to generally accepted accounting principles, liability became fixed at that time.

54. The Joint Venture's financial statement for 1999 - the last full year of its existence - shows net losses for that year of \$4,201,099, and cumulative losses at that time of \$12,952,409. This financial statement was approved by ACSI through Charles Spradling. As of July 31, 2000, the total losses incurred by the Joint Venture exceeded \$14 million. The Joint Venture's tax return for 2000, signed October 1, 2001, shows net losses of more than \$15 million. Greg Taylor, the Joint Venture's auditor and preparer of the Joint Venture's final tax return, testified that all transactions were completed by the time that this final tax return was filed. The Joint Venture's financial statements and tax returns were calculated according to generally accepted accounting principles. Thus, by October 1, 2001, the Joint Venture was wound up, and a net loss in excess of \$15 million was calculated. All of the events required to transform ACSI's liability from a contingent liability to a fixed liability had occurred.

55. Alleged Debtors argue that since ACSI's alleged claims against LaTouf and Copaco had not been liquidated, ACSI's debt is contingent because such claims could potentially eliminate the losses suffered by the Joint Venture in their entirety, and, without losses suffered by the Joint Venture, ACSI has no liability to Copaco. The court rejects ACSI's argument.

56. The Joint Venture Agreement speaks in terms of net losses on the aggregate of all transactions. The agreement does not speak to net losses in general. The Joint Venture Agreement narrowly defines 'transaction' as the buying and selling of cotton. Thus, to determine whether a net loss existed with respect to ACSI's liability, all that is required is an accounting of cotton trades: do all of the cotton trades that the Joint Venture engaged in over the course of its lifetime yield a net positive or net negative balance? There can be no doubt, from the testimony of both parties and from the exhibits introduced, that the Joint Venture's losses resulted from the buying and selling of cotton. The Joint

Venture Agreement does not define the liquidation of assets, either tangible or intangible, as a Joint Venture transaction. Thus, the potential liquidation of alleged claims against LaTouf or Copaco does not alter the net loss on cotton trading, and therefore ‘transactions,’ that existed in the summer of 2001.

57. Settled case law holds that once liability becomes fixed, it is not contingent even though the amount of liability may ultimately be reduced to zero by some future event. *See, e.g., In the Matter of Smith*, 243 B.R. 169, 179 (Bankr. N.D. Ga. 1999); *In re Norris*, 183 B.R. 437, 451 (Bankr. W.D. La. 1995); *In re Nargassans*, 103 B.R. 446, 453-54 (Bankr. S.D.N.Y. 1989); *In re Lambert*, 43 B.R. 913, 922-23 (Bankr. D. Utah 1984). As explained by the Bankruptcy Court for the Southern District of Texas, in an opinion adopted by the Fifth Circuit:

in the ordinary debt arising from, for example, a sale of merchandise, the parties to the transaction would not at that time view the obligation as contingent. Subsequent events might lead to a dispute as to liability because of, for example, defective merchandise, but that would merely serve to render the debt a disputed one but would not make it a contingent one. A legal obligation arose at the time of the sale, although the obligation can possibly be avoided. Such a claim is disputed, but it is not contingent. A claim is contingent as to liability if the debtor’s legal duty to pay does not come into existence until triggered by the occurrence of a future event and such future occurrence was within the actual or presumed contemplation of the parties at the time the original relationship of the parties was created. On the other hand, if a legal obligation to pay arose at the time of the original relationship, but that obligation is subject to being avoided by some future event or occurrence, the claim is not contingent as to liability, although it may be disputed as to liability for various reasons.

In re All Media Props. Inc., 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff’d*, 646 F.2d 193 (5th Cir. 1981)(per curiam). *See also Subway Equip. Leasing Corp. v. Sims (In the Matter of Sims)*, 994 F.2d 210, 220 (5th Cir. 1993).

58. It is undisputed that, in the summer of 2001, losses through the buying and selling of cotton existed in an amount exceeding \$15 million. At that time, ACSI’s liability became fixed. The

claims allegedly held by the Joint Venture against LaTouf and Copaco may, at most, serve to offset the Joint Venture's losses. Once ACSI's liability for such losses became fixed, a later reduction of such losses through the Joint Venture's recovery from LaTouf and Copaco cannot, in and of itself, render ACSI's liability contingent. *See In the Matter of Smith*, 243 B.R. at 179 (holding that, with an "obligation [which] is subject to being avoided by some future event or occurrence, the claim is not contingent as to liability, although it may be disputed as to liability for various reasons"); *In re Norris*, 183 B.R. at 451.

59. The undated Memorandum of Understanding between ACSI and Copaco (probably signed sometime in late 1999 or early 2000) does not alter the court's conclusion. Paragraph four of the Memorandum of Understanding provides that "ACSI recognizes that it owed \$4,375,655 to the joint venture as per audited statements of partners' capital as of December 31, 1998, *subject to any and all claims, offsets or credits* owed to ACSI pursuant to the joint venture agreement or by virtue of role or roles played by Larry LaTouf." (emphasis added). Alleged Debtors argue that this provision conditioned their liability on liquidating the claims allegedly held by the Joint Venture. The court rejects this argument.

60. The memorandum provides that, notwithstanding its provisions, the Joint Venture Agreement remains in effect. Furthermore, ACSI "recognizes" that it was liable to Copaco. Therefore, the amount of liability may be reduced by claims and offsets. If the term 'subject to any and all claims' was meant to condition liability, as opposed to the amount of liability, then ACSI would not have acknowledged its liability. ACSI recognized liability, but not the amount of liability. This conclusion is further evidenced by an October 29, 1999, letter to Copaco from Grady Terrill, the attorney who

represented Alleged Debtors in the negotiation of the Memorandum of Understanding, wherein Mr. Terrill clarified Alleged Debtors' position: "you understand that ACSI by the memorandum of understanding is reserving its right to dispute the *amount* of \$4,375,655 *owed* by ACSI for over draws." (emphasis added). Contingency as to the amount of liability is not the equivalent of contingency as to liability. *See, e.g., In re All Media Props. Inc.*, 5 B.R. at 133.

61. Even assuming that Texas law or the Joint Venture Agreement conditioned Alleged Debtors' liability on the liquidation of all assets, and that the Joint Venture's alleged claims against LaTouf and Copaco were assets that should have been liquidated, the parties must still have contemplated, at the time that their relationship was created, the occurrence of this future event as a condition before ACSI's duty to pay became fixed. *See Subway Equip. Leasing Corp. v. Sims (In the Matter of Sims)*, 994 F.2d 210, 220 (5th Cir. 1993).

62. In the undated Memorandum of Understanding, ACSI stated that "it recognize[d] that it *owed* \$4,375,655 to the joint venture as per audited statements of partner's capital as of December 31, 1998." (emphasis added). If ACSI owed this money in 1999, its liability at that time was not contingent. In connection with an Offer in Compromise submitted to the IRS, Billie Wayne Spradling Jr. signed under penalty of perjury, on July 26, 1999, a statement that "[i]n connection with the ACSI/CC JV, Taxpayer has personally guaranteed bank lines totaling over \$20 million. By the terms of the guarantee, equity in all assets of taxpayer is encumbered." In a subsequent letter to the IRS sent by Billie Wayne Spradling Jr.'s attorney, Billie Wayne Spradling Jr. stated that he "personally guaranteed the payment of any deficit capital balance of ACSI in the ACSI/Copaco JV. The obligation . . . at this time is in excess of \$6,000,000." Similarly, Charles Spradling, in his Offer in Compromise

to the IRS, stated under penalties of perjury that there is a “huge negative capital account shown on the joint venture books, which I have personally guaranteed.”

63. These sworn statements made by the Spradlings to the IRS evidence their belief that they owed millions of dollars to Copaco in 1998, 1999, and 2000. They claimed they could not pay the IRS because of their huge obligations to Copaco. Their statements evidence no condition to liability. The evidence adduced at trial, therefore, reveals that ACSI and its principals believed that they were obligated under the Joint Venture Agreement in 1998, 1999, and 2000. As they acknowledged their obligations well before termination and windup of the partnership, they cannot now plausibly argue that the agreement contemplates a complete liquidation of tangible and intangible assets before liability becomes fixed. The evidence demonstrates that the parties never contemplated that complete liquidation was necessary before liability became fixed. ACSI's debt is not contingent as to liability. *See In the Matter of Sims*, 994 F.2d at 220.

64. Because ACSI's liability to Copaco became fixed before the filing of these petitions, ACSI defaulted on its obligation to Copaco. The only condition to Billie Wayne Spradling Jr.'s and Charles Spradling's personal guarantees of payment of ACSI's obligation was default in payment by ACSI. This condition having occurred, the liability of Billie Wayne Spradling Jr. and Charles Spradling is likewise not contingent.

Whether Copaco's Claims are Subject to a Bona Fide Dispute

65. Alleged Debtors' contention that a bona fide dispute exists is based on (1) amendments to the Joint Venture Agreement that altered both the sharing of profits from sales of cotton initially contributed to the Joint Venture by ACSI and the interest rate charged by Copaco on its loans to the

Joint Venture; (2) Copaco's failure to fund under an allegedly promised loan; and (3) the role and acts of Larry LaTouf.

66. The Fifth Circuit has interpreted the meaning of 'subject to a bona fide dispute' in the context of an involuntary petition. See *In the Matter of Sims*, 994 F.2d at 220-21. In *Sims*, the Fifth Circuit adopted the widely employed 'objective standard' for the determination of this issue, as have most of the other circuits. See *id.* See also *Rimell v. Mark Twain Bank (In re Rimell)*, 946 F.2d 1363, 1365 (8th Cir. 1991); *B.D.W. Assocs. Inc. v. Busy Beaver Bldg. Ctrs. Inc.*, 865 F.2d 65, 66-67 (3d Cir. 1989); *Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1544 (10th Cir. 1988); *In the Matter of Busick*, 831 F.2d 745, 750 (7th Cir. 1987). Under this objective standard, "the bankruptcy court must 'determine whether there is an objective basis for either a factual or a legal dispute as to the validity of the debt.'" *In the Matter of Sims*, 994 F.2d at 221, quoting *In re Rimell*, 946 F.2d at 1365. Accord *B.D.W. Assocs. Inc.*, 865 F.2d at 66-67 (a bona fide dispute exists if there are "substantial factual and legal questions raised by the debtor" bearing upon the debtor's liability), cited by *In the Matter of Sims*, 994 F.2d at 221. *Sims* adopted the Eighth Circuit's standards:

[T]he petitioning creditor must establish a prima facie case that no bona fide dispute exists. Once this is done, the burden shifts to the debtor to present evidence demonstrating that a bona fide dispute does exist. Because the standard is objective, neither the debtor's subjective intent nor his subjective belief is sufficient to meet this burden. The court's objective is to ascertain whether a dispute that is bona fide exists; the court is not to actually resolve the dispute. This does not mean that the bankruptcy court is totally prohibited from addressing the legal merits of the alleged dispute; indeed, the bankruptcy court may be required to conduct a limited analysis of the legal issues in order to ascertain whether an objective legal basis for the dispute exists. Finally, because the determination as to whether a dispute is bona fide will often depend . . . upon an assessment of witnesses' credibilities and other factual considerations, the bankruptcy court's determination in this regard is a factual finding that may be overturned on appeal only if it is clearly erroneous.

In the Matter of Sims, 994 F.2d at 221, quoting *In re Rimell*, 946 F.2d at 1365. “This test does not require the court to determine the probable outcome of a dispute or resolve any genuine issues of fact or law.” *In re Norris*, 183 B.R. 437, 452 (Bankr. W.D. La. 1995).

67. An objective basis for a factual dispute as to the validity of debt envisions facts which, if provable, potentially establish that no debt exists. For example, an oral contract is susceptible to a factual bona fide dispute if the alleged debtor argues that he in fact never made oral promises that form the basis of the debt. See *In re Ballato*, 252 B.R. 553, 557 (Bankr. M.D. Fla. 2000). Accordingly, in such a case, “genuine issues of material fact exist” concerning the validity of the debt. *Id.* Similarly, in a case where the alleged debtor argues that he has not in fact signed his name to a note which forms the basis of the petitioning creditor’s claim, and the alleged debtor introduces credible expert testimony of forgery, a bona fide factual dispute as to the alleged debtor’s liability exists. See *In re Xacur*, 219 B.R. 956, 965 (Bankr. S.D. Tex. 1998).

68. An objective basis for a legal dispute concerning the validity of debt envisions some legal mechanism by which the validity of the debt is called into question. For example, if a creditor takes possession of collateral, and fails to elect between retaining the collateral or disposing of the collateral, such creditor may be deemed under the law to have elected to retain the collateral in full satisfaction of the debt. See *In re Norriss Bros. Lumber Co. Inc.*, 133 B.R. 599, 606 (Bankr. N.D. Tex. 1991). In such a case, a bona fide dispute exists because the liability of the debtor to the creditor may have been legally foreclosed. See *id.* Whether a debtor is liable for services rendered to a related entity is susceptible of a legal dispute, i.e. whether the law makes one vicariously or otherwise liable for

the debts of another. *See In re Cohn-Phillips Ltd.*, 193 B.R. 757, 765-66 (Bankr. E.D. Va. 1996).

Such circumstance raises a bona fide dispute. *See id.*

69. Alleged Debtors admitted that they voluntarily signed the Joint Venture Agreement and the personal guarantees of payment. “[A]n attempt to explain why [alleged debtors] failed to pay . . . does not call into question the validity of their debts.” *In the Matter of Sims*, 994 F.2d at 221. Alleged Debtors presented no viable legal arguments as to how and why their debt to Copaco is negated by LaTouf’s actions or Copaco’s alleged failure to fund. At most, Alleged Debtors’ arguments reflect their subjective belief that Copaco’s alleged misdeeds somehow relieve Alleged Debtors of their liability. It is not subjective belief, however, that counts: “neither the debtor’s subjective intent nor his subjective belief is sufficient to meet [his] burden.” *Id.*, quoting *In re Rimell*, 946 F.2d at 1365.

70. Alleged Debtors’ factual and legal allegations serve only to establish potential counterclaims against Copaco. Their argument that a bona fide dispute exists is premised on their asserted counterclaims: “[o]nce the substantial claims and causes of action held by [the Joint Venture] against Copaco . . . are determined, it is questionable that any debt will be owed by the Alleged Debtors to Copaco.” Alleged Debtors’ Joint Trial Brief ¶ 4.b.

71. The mere existence of other litigation between the parties, or the mere existence of various counterclaims and defenses by the alleged debtor, does not in and of itself establish the existence of a bona fide dispute. *See In the Matter of Sims*, 994 F.2d at 220-21; *In re Norriss Bros. Lumber Co. Inc.*, 133 B.R. 599, 604 (Bankr. N.D. Tex. 1991)(McGuire, C.J.). *See also Chicago Title Ins. Co. v. Seko Inv. Inc. (In re Seko Inv. Inc.)*, 156 F.3d 1005, 1008 (9th Cir. 1998); *Efron v. Gutierrez*, 226 B.R. 305, 313 (D.P.R. 1998); *In re Everett*, 178 B.R. 132, 141-42 (Bankr. N.D.

Ohio 1994); *In re Onyx Telecomms. Ltd.*, 60 B.R. 492, 495-96 (Bankr. S.D.N.Y. 1985). As explained by the Ninth Circuit, “[t]he existence of a counterclaim against a creditor does not automatically render the creditor’s claim the subject of a ‘bona fide dispute.’ So long as the petitioning creditor has established that there is no dispute regarding the debtor’s *liability* on the creditor’s claim, the creditor has standing under section 303(b) to bring a petition.” *Liberty Tool & Mfg. v. Vortex Finishing Sys. Inc. (In re Vortex Finishing Sys. Inc.)*, 277 F.3d 1057, 1066 (9th Cir. 2002)(emphasis added). *See also In re Biogenetic Techs. Inc.*, 248 B.R. 852, 857 (Bankr. M.D. Fla. 1999) (“an alleged debtor’s assertion of a counterclaim against the petitioning creditor, even if the counterclaim is substantive, does not create a bona fide dispute . . . Although counterclaims may reduce the amount of the claim, they do not dispute the merits of the claim itself”); *In re Knoth*, 168 B.R. 311, 316 (Bankr. D.S.C. 1994) (“[c]ounterclaims may work a diminution of the claim, but they do not dispute the merits of the claim itself”), *quoting In re Atwood*, 124 B.R. 402, 409 (S.D. Ga. 1991). “A bona fide dispute must exist as to the validity of an entire claim and not merely some of the claim.” *In re Cohn-Phillips Ltd.*, 193 B.R. 757, 763 (Bankr. E.D. Va. 1996). *Accord In re Broadview Lumber Co. Inc.*, 137 B.R. 775, 776 (Bankr. W.D. Mo. 1992).

72. Not only does the mere existence of counterclaims fail to establish the existence of a bona fide dispute, the result is the same if such counterclaims potentially exceed the amount of the petitioning creditor’s claims. “[T]he statute is not concerned with who ultimately owes money to whom; rather, it is concerned with whether the creditor’s claim is disputed. Although there may be a dispute regarding who ultimately owes money to whom, [alleged debtor] has not really disputed the validity of the claim filed by [petitioning creditor].” *Chicago Title Ins. Co. v. Seko Inv. Inc. (In re Seko Inv.*

Inc.), 156 F.3d 1005, 1008 (9th Cir. 1998). Thus, even if a counterclaim may potentially offset entirely the petitioning creditor's claim, and result in a situation where the petitioning creditor actually owes the alleged debtor money, such a counterclaim does not by itself establish that a bona fide dispute exists. *See id.*; *In re Systems Communications Inc.*, 234 B.R. 143, 144 (Bankr. M.D. Fla. 1999).⁴ *See also IBM Credit Corp. v. Compuhouse Sys. Inc.*, 179 B.R. 474 (W.D. Pa. 1995)(reversing bankruptcy court which had held that bona fide dispute may be established by counterclaim large enough to completely extinguish alleged debtor's liability), *aff'd*, 85 F.3d 612 (3d Cir. 1996). This is especially the case with a counterclaim arising from a wholly separate transaction – such a counterclaim does not establish a bona fide dispute. *See In re Vortex Finishing Sys. Inc.*, 277 F.3d at 1065 n.2.

73. Alleged Debtors depend on the mere existence of potential counterclaims to establish that a bona fide dispute exists. This is insufficient. *See In the Matter of Sims*, 994 F.2d at 220-21; *In re Norriss Bros. Lumber Co. Inc.*, 133 B.R. at 604.

74. Copaco met its burden of establishing a prima facie case that no bona fide dispute exists. *See In the Matter of Sims*, 994 F.2d at 221; *B.D. Int'l Disc. Corp. v. Chase Manhattan Bank (In re B.D. Int'l Disc. Corp.)*, 701 F.2d 1071, 1077 (2d Cir. 1983) (holding that petitioning creditor satisfies burden by establishing “that there are good grounds for the claim and that no defenses have been asserted in substantiable form”); *In re Audio Visual Workshop Inc.*, 211 B.R. 154, 158

⁴At least one judge has noted that the existence of a counterclaim necessarily admits the validity of the original claim: “[w]hen one examines the true nature of the counterclaim, it should immediately be evident that the proposition urged by counsel for the Debtor is without merit. The assertion of a counterclaim admits that the creditor has a valid claim, albeit it may be subject to a reduction or ultimate elimination or even possibly a recovery by the counterclaimant if the claim exceeded the amount of the claim to which the counterclaim is addressed. It logically follows from the foregoing if there is no valid claim there cannot be a counterclaim.” *In re Systems Communications Inc.*, 234 B.R. 143, 144 (Bankr. M.D. Fla. 1999).

(Bankr. S.D.N.Y. 1997). The burden then shifted to Alleged Debtors to present evidence that a bona fide dispute exists. *See In the Matter of Sims*, 994 F.2d at 221.

75. It is not enough for Alleged Debtors to state that they have claims and defenses against Copaco. *See id.* at 220-21. They must objectively demonstrate the existence of such claims or defenses. *See id.* In this respect, Alleged Debtors presented testimony that reflected negatively on LaTouf. However, Alleged Debtors did not show how or why such facts constituted actionable wrongdoings by Copaco. Alleged Debtors presented no specific legal theories, they enumerated no elements of any causes of action or defenses, and they made no attempt to connect the facts with the elements of a cause of action or defense.

76. Alleged Debtors argue that Copaco unfairly and wrongly altered the terms of the original Joint Venture Agreement. The original agreement provided that ACSI would receive 80% and Copaco 20% of the profits on 165,000 bales of cotton on ACSI's forward book of cotton transactions contributed initially by ACSI to the Joint Venture. On October 6, 1993, the parties modified this original provision to provide that the profits from the 165,000 bales would be split 50-50. In addition, on February 1, 1993, the parties, by signed amendment to the Joint Venture Agreement, altered the interest rate charged by Copaco. Alleged Debtors provided no explanation why these two amendments were improper or unenforceable. ACSI voluntarily signed the amendments, and the amendments were entered into in adherence with provisions of the Joint Venture Agreement.

77. Even assuming, however, that Alleged Debtors have claims against Copaco based on these amendments, and that Alleged Debtors succeed entirely on these claims, Alleged Debtors' remedies would be limited to actual damages: the profit that they lost on the original 165,00 bales of

cotton and the excess amount of interest that the Joint Venture paid Copaco. Any recovery, therefore, would serve only to lessen the amount of Alleged Debtor's liability to Copaco. As such, Alleged Debtors' claims against Copaco for the amendments to the Joint Venture Agreement do not establish that a bona fide dispute exists. *See In the Matter of Sims*, 994 F.2d at 221 (holding that potential counterclaim against creditor for creditor's alleged failure to mitigate contract damages does not constitute a substantial factual or legal question bearing on the debtor's liability because "any such failure [to mitigate damages] would serve only to reduce the amount of" creditors' claims). *See Dorsett Bros. Concrete Supply Inc. v. Safeco Title Ins. Co.*, 880 S.W.2d 417, 420 (Tex. App. – Houston [14th Dist.] 1993, writ denied); *Morgan v. Amarillo Nat'l Bank*, 699 S.W.2d 930, 937 (Tex.App. – Amarillo 1985, writ ref'd n.r.e.).

78. Alleged Debtors contend they incurred losses because Copaco failed to provide additional funding after the \$14 million had been advanced under the Joint Venture Agreement. This, they argue, was at a critical time for the Joint Venture and prevented it from recouping many of its losses. However, Alleged Debtors made no showing that Copaco was obligated to provide additional financing.

79. Alleged Debtors made no objective showing of a claim that they or the Joint Venture have against Copaco for Copaco's alleged failure to fund.

80. Alleged Debtors contend that Larry LaTouf's conduct gives rise to valuable counterclaims and defenses against Copaco. Alleged Debtors articulated no causes of action that they have against LaTouf or against Copaco based on LaTouf's role, nor did they specify exactly which of LaTouf's actions constituted actionable wrongs under Texas law. Billie Wayne Spradling Jr. testified

that Copaco put LaTouf in charge, that LaTouf made all the bad decisions that resulted in losses to the Joint Venture, that LaTouf lost money on futures, and that LaTouf ‘fixed’ the books to show a profit resulting in improper distributions to the partners. Alleged Debtors’ expert witness, Grady Terrill, mentioned that the Joint Venture may hold a breach of contract claim against Copaco. Presumably, this claim contemplates an action against Copaco for taking over the day-to-day management of the Joint Venture in violation of the Joint Venture Agreement. Alleged Debtors generally complain that LaTouf extorted ownership in, and control of, ACSI and the Joint Venture.

81. Alleged Debtors asserted claims against Copaco for the role of LaTouf fall into two categories: claims against Copaco based on Copaco’s actions, i.e. putting LaTouf in charge and thereby taking over management of the Joint Venture; and claims against Copaco based on LaTouf’s actions – LaTouf extorting money and ownership, making himself chairman of ACSI’s board, authorizing inappropriate draws, and making all the bad trading decisions.

82. While not specifically identified by Alleged Debtors, their complaints regarding LaTouf are in the nature of fraud, duress, or breach of fiduciary duty. Possible remedies for these causes of action or defenses under Texas law include rescission of contract or avoidance of debt. *See United Teachers Assocs. Ins. Co. v. MacKeen & Bailey Inc.*, 847 F. Supp. 521, 542 (W.D. Tex. 1994), *rev’d on other grounds*, 99 F.3d 645 (5th Cir. 1996); *Humphrey v. Camelot Ret. Cmty.*, 893 S.W.2d 55, 59 (Tex. App. – Corpus Christi 1994, no writ); *Lowrey v. University of Tex. Med. Branch at Galveston*, 937 S.W.2d 171, 174 (Tex. App. – El Paso 1992, writ denied). Such remedies may bring liability into doubt. *See Liberty Tool & Mfg. v. Vortex Finishing Sys. Inc. (In re Vortex Finishing Sys. Inc.)*, 277 F.3d 1057, 1066-67 (9th Cir. 2002); *In re Elsa Designs Ltd.*, 155

B.R. 859, 869 (Bankr. S.D.N.Y. 1993); *In re Norriss Bros. Lumber Co. Inc.*, 133 B.R. 599 at 606-07 (Bankr. N.D. Tex. 1991). Thus, unlike ordinary counterclaims, which do not establish the existence of a bona fide dispute, the assertion of causes of action or defenses which potentially serve to void liability may indeed suffice to establish the existence of a bona fide dispute. *See In re Vortex Finishing Sys. Inc.*, 277 F.3d at 1066-67.

83. Copaco argues, among other things, that Alleged Debtors' claims based on the role of LaTouf are barred by applicable statutes of limitation. However, Alleged Debtors claims against Copaco, because said claims are used defensively, most likely survive the applicable statutes of limitation. *See Villages of Greenbriar v. Torres*, 874 S.W.2d 259, 266 (Tex. App. – Houston [1st Dist.] 1994, writ denied); *Cooper v. Republicbank Garland*, 696 S.W.2d 629, 634 (Tex. App. – Dallas 1985, no writ).

Claims Against Copaco Based on Copaco's Actions

84. The Joint Venture Agreement permitted Copaco to place its employee or representative on the premises of the Joint Venture. Thus, LaTouf's initial involvement with the Joint Venture did not violate the Joint Venture agreement.

85. Poor or improper business decisions by LaTouf, resulting in losses to the Joint Venture is not relevant: a partner-creditor who loans the partnership money is not liable for the losses caused by such partner-creditor's agent's mismanagement of the partnership. *See Cameron v. First Nat. Bank of Decatur*, 4 Tex. Civ. App. 309, 312, 23 S.W. 334, 335 (1893). In *Cameron*, an old but valid

case, a bank was a partner in a partnership which owned and operated a mill.⁵ *See id.* The bank also loaned the partnership money, thereby becoming a partner-creditor. *See id.*, 4 Tex. Civ. App. at 310-11, 23 S.W. at 334-35. When the bank sought to collect its loans to the partnership, the other partners charged that the bank ought not to be able to do so, because the bank's president, vice president, and manager had allegedly made the decisions that cost the partnership money. *See id.*, 4 Tex. Civ. App. at 312, 23 S.W. at 335.

The court rejected the argument that the bank's negligence in running the mill somehow vitiated the partnership's duty to pay its debt to the bank. *See id.* The court further held that "[t]he fact that Greathouse was the common agent of the bank and the mill did not make his acts in operating the mill the acts of the bank. The bank, as such, had no more to do with the operations of the mill than any other member of the [partnership]; and, if Greathouse was guilty of negligence of which appellants can complain, it was as agent of their own selection, and not as agent of the bank." *Id.* LaTouf became an agent of ACSI when he became a part-owner and chairman of the board of ACSI. As the common agent of both ACSI and Copaco (if LaTouf is in fact guilty of negligence of which ACSI can complain), LaTouf was as agent of their own selection, and not an agent of Copaco. *See id.* Additionally, even if LaTouf did act only as Copaco's agent in managing the Joint Venture, "negligence in the management of the affairs of a general partnership or joint venture does not create any right of action against that

⁵The mill was actually a joint stock company. *See Cameron v. First Nat. Bank of Decatur*, 4 Tex. Civ. App. 309, 310-11, 23 S.W. 334 (1893). However, under then existing Texas law, the court noted that the liability of the shareholders to an unchartered joint stock company was the same as the liability of partners to the partnership's creditors. *See id.*, 4 Tex. Civ. App. at 312, 23 S.W. at 335. Thus, for the purposes of the court's opinion in *Cameron* and of this memo, the joint stock company at issue in *Cameron* may be said to have been a partnership.

partner by other members of the partnership.” *Ferguson v. Williams*, 670 S.W.2d 327, 331 (Tex. App. – Austin 1984, writ ref’d n.r.e.).

86. Assuming, *arguendo*, that LaTouf in fact caused all of the Joint Venture’s losses, neither LaTouf’s presence at and mismanagement of the Joint Venture, nor LaTouf’s role as dual agent for both ACSI and Copaco, make Copaco liable under Texas law for LaTouf’s role in the Joint Venture. *See id*; *Cameron*, 4 Tex. Civ. App. at 312, 23 S.W. at 335. The Joint Venture Agreement may, however, impose liability. The Joint Venture Agreement provided that “the management and control of the day to day operation of the Venture and the maintenance of the Venture’s property shall rest exclusively with ACSI.” If Copaco somehow breached this provision, Copaco would potentially be liable for losses caused by LaTouf. However, Billie Wayne Spradling Jr. and Charles Spradling gave LaTouf a one third ownership interest in ACSI and voted LaTouf chairman of ACSI’s board. Thus, if LaTouf did in fact commandeer the operations of the Joint Venture, he did so as an owner, officer, and board member of ACSI. It does not constitute evidence of Copaco violating the Joint Venture Agreement.

87. Nonetheless, Alleged Debtors argue that LaTouf extorted ownership of and control of ACSI, and control of the Joint Venture. They claim that they had no choice but to comply with LaTouf’s demands under threat of LaTouf pulling the Joint Venture’s funding. Thus, they argue, ACSI did not voluntarily handover control of the Joint Venture to LaTouf, but such control was taken by Copaco through extortion. This argument concerns the actions of LaTouf and not of Copaco, and will thus be considered together with the other complaints that Alleged Debtors assert against Copaco based on LaTouf’s actions.

88. Alleged Debtors made no objective showing of any cause of action or defense directly against Copaco on their claim that Copaco put LaTouf in charge, that Copaco took over control of the Joint Venture through LaTouf, and that Copaco, through LaTouf, caused losses to the Joint Venture.

Claims Against Copaco for LaTouf's Actions

89. With respect to holding Copaco liable for LaTouf's actions, Alleged Debtors argue that LaTouf, as an officer, employee, and representative of Copaco, *was* Copaco. When LaTouf acted in the Joint Venture, Alleged Debtors contend that they understood and believed that Copaco was acting. Legally and factually, therefore, Alleged Debtors assume that LaTouf's actions bound Copaco in every way.

90. Alleged Debtors are correct in that the acts of a corporate officer or vice-principal usually bind the corporation. *See, e.g., GTE Southwest Inc. v. Bruce*, 998 S.W.2d 605, 618 (Tex. 1999). A corporation can only act through its agents. *See id.* However, under Texas law, the acts of a corporate officer or vice-principal are not per se the acts of the corporation. *See, e.g., Crescendo Invs. Inc. v. Brice*, 61 S.W.3d 465, 475 n. 10 (Tex. App. – San Antonio 2001, pet. denied). Alleged Debtors incorrectly assume that because LaTouf was an officer and agent of Copaco, Copaco is liable for his wrongdoings. *See Tompkins M.D. v. Cyr*, 995 F. Supp. 664, 683 (N.D. Tex. 1998); *Rhodes Inc. v. Duncan*, 623 S.W.2d 741, 744 (Tex. App. – Houston [1st Dist.] 1981, no writ) (“the liability of a corporation for the acts of its vice principal is . . . limited to those acts which are referable to the company's business to which the vice principal is expressly, impliedly or apparently authorized to transact”).

91. Because LaTouf was an officer of Copaco, the court analyzes Copaco's potential liability for LaTouf's actions under the doctrine of vice-principal liability. *See Hammerly Oaks Inc. v. Edwards*, 958 S.W.2d 387, 391 (Tex. 1997); *Shamrock Communications Inc. v. Wilie*, 2000 WL 1825501 *4 (Tex. App. – Austin 2000, pet. denied). Under vice-principal liability, the acts of a vice-principal are deemed to be the acts of the corporation itself. *See Hammerly*, 958 S.W.2d at 391. However, only those acts committed by the vice principal which are referable to the business of the corporation, or are committed by the vice principal within the scope and course of his employment, are the acts of the corporation itself. *See Cyr*, 995 F. Supp. at 683 (“Under familiar principles of agency law, a corporation is liable for the intentional torts of its officers committed within the course and scope of their employment”); *Wal-Mart Stores Inc. v. Odem*, 929 S.W.2d 513, 530 (Tex. App. – San Antonio 1996, writ denied)(“any recovery against a corporation for tort must be based on the wrongful act of an officer or agent, within the course or scope of his employment”); *Horton v. Robinson*, 776 S.W.2d 260, 267 (Tex. App. – El Paso 1989, no writ) (“A corporation cannot be held liable for the acts of a principal which are not referrable [sic] to corporate business and which are unauthorized by the corporation”); *Rhodes Inc.*, 623 S.W.2d at 744.

92. In this context, the liability of a corporation for the acts of its officer is the same as the liability of the corporation under *respondeat superior*: the conduct complained of must have occurred within the course and scope of the officer's employment. *See Martinez v. Hines Interests Ltd. P'ship*, 1997 WL 634162 *7 (Tex. App. – Houston [14th Dist. 1997, pet. denied).

As explained by the Fifth Circuit:

the employer's broad liability is limited in that an employee who detours from the employer's business is not acting within the scope of employment. In Texas, when the servant turns aside, for however short a time, from the prosecution of the master's work to engage in an affair wholly his own, he ceases to act for the master, and the responsibility for that which he does in pursuing his own business or pleasure is on him alone.

Rodriguez v. Sarabyn, 129 F.3d 760, 767 (5th Cir. 1997) (internal quotations omitted). "Moreover, the Texas cases have long held that only officers and agents of a corporation . . . have the authority to act for the corporation, *and then only as to routine matters arising in the ordinary course of business.*" *Kiepfer M.D. v. Beller*, 944 F.2d 1213, 1218 (5th Cir. 1991)(emphasis added).

93. While Texas courts have not definitively defined 'course and scope of employment' in the context of vice-principal liability, the Restatement of Agency provides that "[a]n act of a servant is not within the scope of employment if it is done with no intention to perform it as a part of or incident to a service on account of which he is employed." RESTATEMENT (SECOND) OF AGENCY § 235 (1958). There are actions which no vice principal of a corporation may commit in the corporation's name unless explicitly authorized because such actions cannot constitute the corporation's business or the vice principal's employment. *See Upper Valley Aviation Inc. v. Mercantile Nat'l Bank*, 656 S.W.2d 952, 956 (Tex. App. – Dallas 1983, writ ref'd n.r.e.). These instances usually involve a vice principal's actions for his own benefit. *See id.* (holding that corporation not bound by vice principal's transfer of corporate assets to his personal creditor); *Passmore v. Dallas Distrib. Co.*, 1 S.W.2d 666 (Tex. Civ. App. – San Antonio 1927, no writ). This is especially the case when the party dealing with the vice principal knows that the vice principal has an interest in the transaction and that the vice principal's actions are for his own benefit and not for the corporation's. *See Electrical Contracting & Maint. Co. v. Perry Distribs. Inc.*, 432 S.W.2d 543, 546 (Tex. Civ. App. – Dallas, 1968 writ ref'd n.r.e.)

(noting that corporation not liable “when the agent is president of the corporate principal, but is interested as an individual in the transaction and such personal interest is known to the person dealing with him”); *Passmore*, 1 S.W.2d at 667-68 (finding that third party had full notice and knowledge of fact that the groceries sold by them to vice principal were for the personal use and benefit of vice principal and not corporation; furthermore, third party delivered the groceries only to the vice principal’s private residence).

94. A corporation may be liable for the acts of a vice principal, even if the vice principal committed such acts outside of the scope and course of his employment, if the corporation subsequently ratifies such vice principal’s acts. “Ratification may occur when a principal, though he had no knowledge originally of the unauthorized act of his agent, retains the benefits of the transaction after acquiring full knowledge.” *Land Title Co. of Dallas Inc. v. F. M. Stigler Inc.*, 609 S.W.2d 754, 756 (Tex. 1980). The critical factor in determining whether a principal has ratified an unauthorized act by his agent is the principal’s knowledge of the transaction and his actions in light of such knowledge. *See id.* However, there can be no ratification when the act committed by the vice principal is not committed on behalf of the corporation. *See Horton*, 776 S.W.2d at 267.

95. Alleged Debtors failed to provide evidence indicating that Copaco may be liable under principles of vice principal liability. Copaco had no knowledge of LaTouf’s actions and did not authorize or ratify LaTouf’s actions. Copaco became aware of LaTouf’s involvement as chairman of ACSI’s board no earlier than September, 1995. Only later did Copaco become aware of LaTouf’s ownership interest in ACSI. LaTouf resigned from Copaco on January 1, 1996. Thus, only a few

months, if any, went by that Copaco was aware of LaTouf's role and that LaTouf was an officer of Copaco. By then, however, most of the acts that Alleged Debtors complain of had occurred.

96. None of LaTouf's actions benefited Copaco or were undertaken on behalf of Copaco. Mr. Spradling understood this when, in July of 2000, he wrote Copaco a letter wherein he stated, "Larry LaTouf took advantage of both of us." The \$100,000 payment went to World Bridge Trading, not to Copaco. His share of ACSI's profits went to him individually, not to Copaco. LaTouf benefited personally from any undue draws that he authorized, because such undue draws went to ACSI and therefore to himself as an owner of ACSI. By allegedly threatening to withdraw funding from the Joint Venture, LaTouf clearly exceeded any actual or apparent authority and acted only for himself. Alleged Debtors understood that LaTouf's actions were undertaken for his own benefit. There is no evidence that Copaco either instructed LaTouf, or benefited from his actions.

97. Alleged Debtors knew that LaTouf could only have been working for his own benefit by allegedly extorting money and ownership of ACSI. Alleged Debtors had capable legal advice throughout their dealings with LaTouf. They had legal and contractual rights in the face of LaTouf's demands. Yet Alleged Debtors nonetheless engaged in, and made possible, LaTouf's role of which they now complain, without ever, until well after LaTouf's disappearance from the scene, raising an objection with Copaco.

98. LaTouf acted only in his own interest and outside the scope and course of his employment with Copaco. Alleged Debtors accommodated LaTouf and profited by his alleged improper conduct to the extent that they also received unauthorized draws. *See Crisp v. Southwest Bancshares Leasing Co.*, 586 S.W.2d 610, 615 (Tex. Civ. App. – Amarillo 1979, writ ref'd n.r.e.)

(“holding that corporation was not liable for the acts of its president where the president acted in collusion with others to defraud the corporation”). No evidence of ratification was introduced at trial. What is left, therefore, is nothing more than Alleged Debtors’ subjective belief that LaTouf’s actions relieve them of their obligation to pay Copaco.

99. The evidence is insufficient to objectively demonstrate that Copaco may be liable to Alleged Debtors for LaTouf’s actions. *See Upper Valley Aviation Inc.*, 656 S.W.2d at 956; *Electrical Contracting & Maint. Co.*, 432 S.W.2d at 546; *Passmore*, 1 S.W.2d at 667-68.

Personal Guarantees of Billie Spradling Jr. and Charles Spradling

100. The personal guarantees of Billie Wayne Spradling Jr. and Charles Spradling are guarantees of payment under Texas law. Billie Wayne Spradling Jr. and Charles Spradling guaranteed “payment of any obligation of” ACSI under the loss sharing provision of the Joint Venture Agreement. It is undisputed that, on the final transaction date, the Joint Venture had massive losses. ACSI’s liability was then fixed, thereby triggering the personal guarantees of Billie Wayne Spradling Jr. and Charles Spradling. As there is no dispute that losses, as contemplated by the Joint Venture Agreement’s loss sharing provision, existed, Billie Wayne Spradling Jr. and Charles Spradling guaranteed payment of such losses.

101. Billie Wayne Spradling Jr. and Charles Spradling do not contend that their guarantees are factually or legally voidable. Nor did they present any evidence that losses, as contemplated by their guarantees, did not in fact exist. They have not argued that they have claims or defenses against Copaco based on the guarantees, such as fraud in the inducement in signing the guarantees, failure of consideration for the guarantees, or material alteration of the guarantees. The thrust of their argument is

that, as guarantors, they are entitled to assert the same defenses against the creditor as is the principal obligor. Thus, they do not seek to demonstrate the existence of a bona fide dispute between themselves and Copaco regarding their liability under their guarantees. Rather, they seek to demonstrate the existence of a bona fide dispute between ACSI and Copaco – a defense which they, as guarantors, then seek to interpose between themselves and Copaco.

102. Merely because the principal obligor's liability is subject to a bona fide dispute does not necessarily mean that the absolute guarantor's liability is likewise subject to a bona fide dispute. Under Texas law, Copaco can sue Billie Wayne Spradling Jr. or Charles Spradling individually without also suing ACSI. *See Cox v. Lerman*, 949 S.W.2d 527, 530 (Tex. App. – Houston [14th Dist.] 1997, no writ); *Ford v. Darwin*, 767 S.W.2d 851, 854 (Tex. App. – Dallas 1989, writ denied). Copaco has a claim against each of the Alleged Debtors separate and apart from its claims against the other Alleged Debtors. Billie Wayne Spradling Jr. and Charles Spradling complain of no alleged wrongs committed by Copaco against them individually in connection with their guarantees. In such a situation, therefore, Billie Wayne Spradling Jr.'s and Charles Spradling's only defense to their liability under their guarantees is to employ ACSI's claims and defenses. Thus, where the principal obligor's debt is subject to a bona fide dispute, the absolute guarantor's debt may not be so subject, unless the same defenses that the principal obligor employs against liability may likewise be employed by the absolute guarantor.

103. Generally, equity allows a guarantor to assert the principal obligor's claims against the creditor as a setoff or recoupment of the creditor's claim against the guarantor when the principal obligor and guarantor are joined in suit. *See Hart v. First Fed. Sav. & Loan Ass'n*, 727 S.W.2d 723, 725 (Tex. App. – Dallas 1987, no writ). However, an absolute guarantor may not assert

defenses personal to the principal obligor. *See FDIC v. Griffin*, 935 F.2d 691, 700 (5th Cir. 1991); *Resolution Trust Corp. v. American Residential Props. Inc.*, 1991 WL 540035 *6 (N.D. Tex. 1991); *FDIC v. Wilson*, 722 F. Supp. 306, 311 n.25 (N.D. Tex. 1989); *Continental Illinois Nat'l Bank & Trust Co. of Chicago v. Windham*, 668 F. Supp. 578, 584-85 (E.D. Tex.1987); *Universal Metals & Mach. Inc. v. Bohart*, 539 S.W.2d 874, 879 (Tex. 1976); *Dennen v. Town N. Nat'l Bank*, 1996 WL 457954 *4 (Tex. App. – Dallas 1996, no writ).

104. Alleged Debtors' failure to specify the claims or defenses that ACSI has against Copaco makes it difficult to determine whether such claims or defenses are personal. The most obvious of such claims or defenses involve allegations of fraud, misrepresentation, and duress. These claims and defenses are personal to the principal obligor. *See Continental Illinois Nat'l Bank*, 668 F. Supp. at 584-85. Similarly, personal contract defenses belonging to the principal obligor are unavailable to the absolute guarantor. *See Farmers & Merchs. State Bank of Krum v. Reece Supply Co.*, – S.W.3d –, 2002 WL 1026978 *4 (Tex. App. – Eastland 2002, no pet.). Because ACSI's claims and defenses against Copaco are personal, they may not be raised as claims and defenses by Billie Wayne Spradling Jr. and Charles Spradling. *See, e.g., Continental Illinois Nat'l Bank*, 668 F. Supp. at 584-85; *Dennen*, 1996 WL 457954 at *4.

105. The bases, therefore, that Billie Wayne Spradling Jr. and Charles Spradling advance as demonstrating the existence of a bona fide dispute between themselves and Copaco, namely ACSI's claims and defenses, are unavailable to them individually. Billie Wayne Spradling Jr. and Charles Spradling have failed to show how they may employ ACSI's claims or defenses against their own liability. They have made no objective showing of a factual or legal dispute to the validity of their debt

to Copaco because they have not attacked *their* liability under the guarantees. They have only attacked ACSI's liability. Accordingly, even if ACSI's debt is subject to a bona fide dispute on the basis of its claims and defenses against Copaco – the only basis presented – the debts of Billie Wayne Spradling Jr. and Charles Spradling are not subject to a bona fide dispute.

Summary of Bona Fide Dispute Contention

106. In conclusion, Alleged Debtors are incorrect in attempting to demonstrate the existence of a bona fide dispute through their belief that their alleged counterclaims may offset their liability to Copaco in its entirety. For this reason alone, no bona fide dispute in this case exists. Nevertheless, Alleged Debtors failed to present an objective demonstration of any viable claims or defenses that they may assert. For this reason, too, no bona fide dispute exists. Finally, an independent analysis of Alleged Debtors' factual allegations yields the same result. Regarding the amendments to the Joint Venture Agreement and Copaco's alleged failure to fund, Alleged Debtors would at most be entitled to damages, which would only decrease the amount of Copaco's claim. With respect to the role of LaTouf, Alleged Debtors failed to demonstrate that Copaco committed any actionable wrongs. Furthermore, Alleged Debtors failed to address the issue of why and how Copaco is liable for LaTouf's actions. Similarly, with respect to Billie Wayne Spradling Jr.'s and Charles Spradling's guarantees, Alleged Debtors have failed to establish a bona fide dispute.

107. Alleged Debtors have failed to carry their burden to demonstrate an objective basis for either a factual or a legal dispute to the validity of their debt. *See Subway Equip. Leasing Corp. v. Sims (In the Matter of Sims)*, 994 F.2d 210, 220-21 (5th Cir. 1993).

Whether Alleged Debtors Are Generally Paying Their Debts As They Become Due

108. The determination of whether Alleged Debtors are generally paying their debts must be made as of the date of the petition. *See Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540,1546 (10th Cir. 1988); *Hayes v. Rewald (In the Matter of Bishop, Baldwin, Rewald, Dillingham & Wong Inc.)*, 779 F.2d 471, 475 (9th Cir. 1985). This is a question of fact on which Copaco, as petitioning creditor, has the burden of proof by a preponderance of the evidence. *See Concrete Plumbing Serv. Inc. v. King Constr. Co. Inc. (In re Concrete Plumbing Serv. Inc.)*, 943 F.2d 627, 630 (6th Cir. 1991); *In re Valdez*, 250 B.R. 386, 392 (D. Or. 1999); *In re Norris*, 183 B.R. 437, 449 (Bankr. W.D. La. 1995).

109. This district employs a widely adopted four element analysis in determining whether an alleged debtor is generally paying its debts as they become due. *See In re Moss*, 249 B.R. 411, 422 (Bankr. N.D. Tex. 2000). *See also Crown Heights Jewish Cmty. Council Inc. v. Fischer (In re Fischer)*, 202 B.R. 341, 350 (E.D.N.Y. 1996); *In re Norris*, 183 B.R. 437, 456-57 (Bankr. W.D. La. 1995); *In re Ramm Indus. Inc.*, 83 B.R. 815, 824 (Bankr. M.D. Fla. 1988). The four factors that the court must consider are: (1) the number of unpaid claims; (2) the amount of such claims; (3) the materiality of the non-payments; and (4) the alleged debtor's overall conduct in its financial affairs. *See In re Moss*, 249 B.R. at 422.

110. An alleged debtor may not be paying its debts as they become due, even if the alleged debtor is not paying only one or two creditors, when those creditors hold the overwhelming majority of debt. *See In re Concrete Plumbing Serv. Inc.*, 943 F.2d at 630; *In re Moss*, 249 B.R. at 422-23; *In re Fischer*, 202 B.R. at 350-51 ("There is substantial authority for the proposition that even though an

alleged debtor may owe only one debt, or very few debts, an order for relief may be granted where such debt or debts are sufficiently substantial to establish the generality of the alleged debtor's default"). Thus, factors (1) and (2) work in an inverse tandem relationship: if the alleged debtor is not paying a small number of claims, then the value of such claims must be large in order to grant relief; or, if the alleged debtor is not paying a large number of claims, the value of such claims must be small in order to deny relief. *See, e.g., In re All Media Props. Inc.*, 5 B.R. 126, 143 (Bankr. S.D. Tex. 1980) ("Where the debtor has few creditors, the number which will be significant will be fewer than when the debtor has a large number of creditors"), *aff'd* 646 F.2d 193 (5th Cir. 1981). Some courts have applied a 50% standard, implying that an alleged debtor is not generally paying its debts as they become due when the unpaid debts total more than 50% of the debtor's debt. *See In re Fischer*, 202 B.R. at 350-51; *In re Garland Coal & Mining Co.*, 67 B.R. 514, 522 (Bankr. W.D. Ark. 1986); *Hill v. Cargill Inc. (In re Hill)*, 8 B.R. 779, 780-81 (D. Minn. 1981).

Whether ACSI Is Generally Paying Its Debts

111. ACSI owes over \$7.7 million to Copaco. This debt is not subject to a bona fide dispute; ACSI has defaulted on this debt to Copaco. ACSI, as a joint venturer, is obligated on the Joint Venture's debts to trade creditors, consisting of eight creditors owed approximately \$38,000. Immediately before these involuntaries were filed, ACSI paid the trade claim of S & L Truck Brokerage Inc. to prevent S & L Truck Brokerage Inc.'s joinder as a petitioning creditor. ACSI has no creditors that it is presently paying. ACSI was not generally paying its debts as such debts become due on the date of filing.

Whether Charles Spradling Is Generally Paying His Debts

112. Charles Spradling has likewise defaulted on his over \$7.7 million debt to Copaco. Additionally, Charles Spradling owes extensive credit card debt to MBNA, to American Express, to Citi, and to Discover. His available credit with all four creditors is zero. He makes interest only payments against the credit card debt, which does not constitute payment. *See In re Moss*, 249 B.R. at 423. He has had checks to creditors returned for insufficient funds. The IRS assessed a \$141,000 tax deficiency against him which he has still not paid or settled, and he is involved in a lawsuit for back taxes filed by Lubbock County taxing entities.

113. Charles and Christie Spradling's house was foreclosed in December 2001. He testified he was unaware of this sale. He transferred other real property titled in his name only days before the IRS was about to file a tax lien against such property. His testimony generally revealed a callous disregard for, ambivalence to, and ignorance of his financial obligations. His stock answer to several questions about his obligations was "I don't know." He lost many of his financial documents, including those relating to the financial history of the Joint Venture. He has not filed his federal tax returns for 2000 or 2001. He used the Joint Venture's and ACSI's funds for his personal use, with no intention of repayment.

114. Charles Spradling attempted to avoid his obligations to creditors and to hide assets. His overall conduct in his financial affairs has been exceedingly poor. Accordingly, Charles Spradling was not generally paying his debts as such debts became due on the date of filing.

Whether Billie Wayne Spradling Jr. is Generally Paying His Debts

115. Billie Wayne Spradling Jr. has likewise defaulted on his over \$7.7 million debt to Copaco. He contends that he has not defaulted on any other debts, and that he has no other creditors. A closer inspection of the record, however, reveals that Billie Wayne Spradling Jr. has several creditors, in addition to Copaco, and that he has defaulted on his obligations to such creditors.

116. Billie Wayne Spradling Jr. is a one-third shareholder of Spradling Group Inc. This corporation's 1997 tax return lists loans to stockholders of \$361,194. Billie Wayne Spradling Jr. testified that he has not paid his share of these loans back to the corporation, testifying instead, 'how could he pay himself.' As of December 31, 2000, Billie Wayne Spradling Jr. owed \$41,948.16 to ACSI for amounts drawn on ACSI's accounts for personal use. He is still obligated to ACSI. He has no intention of repaying such debts to Spradling Group Inc. or ACSI.

117. The question of Billie Wayne Spradling Jr.'s debt to his former wife, Mary Jo, is complicated. On his July 26, 1999, offer of compromise to the IRS, he represented, under penalty of perjury, that he owed Mary Jo \$250,000 in connection with their divorce decree. At trial, he testified that she had forgiven this debt because (1) he pays for his daughter's plane tickets when she visits Mary Jo in Utah; (2) he paid for Mary Jo's car; and (3) he built Mary Jo a house. He testified that he makes no payments to Mary Jo on this debt. A detailed analysis of the divorce decree entered by the court in Lubbock on October 11, 1995, shows the following: that he was required to pay Mary Jo \$180,000 in 120 consecutive monthly payments of \$1,500 each; that he was ordered to pay for his daughter's and Mary Jo's plane tickets in connection with visitation rights; that he was granted custody of his daughter; that he was required to pay any unpaid balance on Mary Jo's car; and that Mary Jo was awarded the

couple's house in Utah. Billie Wayne Spradling Jr.'s testimony that Mary Jo considers his debt to her forgiven is contrary to the divorce decree – the decree obligates him for the very items that supposedly constitute consideration for Mary Jo's forgiveness of the \$180,000 debt. It is not plausible that Mary Jo forgave the debt. Billie Wayne Spradling Jr. presented no corroborating evidence to substantiate his contention. Billie Wayne Spradling Jr.'s testimony is not credible on this point.

118. Billie Wayne Spradling Jr. has defaulted on approximately \$3,350 of bills for professional accounting services from D. Williams & Co. in connection with his 1998 and 2000 personal income taxes.

119. As for Billie Wayne Spradling Jr.'s overall conduct in his financial affairs, the evidence shows such conduct to be poor. He has taken draws from several of his entities, which the entities record as loans. Because the draws are categorized as loans, as opposed to income, Billie Wayne Spradling Jr. has paid no taxes on such loans. He does not intend to repay these loans, nor has he declared the loans as forgiveness of debt on his tax returns. The IRS assessed a large civil penalty against Billie Wayne Spradling Jr. in 1999 for unpaid income taxes from 1988 through 1998. However, Billie Wayne Spradling Jr. continued to take draws from ACSI untaxed, and from ACSI II untaxed. He has not filed his income tax return for 2001, nor paid any estimated taxes on substantial income earned during 2001.

120. Billie Wayne Spradling Jr. testified that he purchased AMCOT, Inc. to distance himself from ACSI and to continue trading cotton. Yet he obtained an assumed name for AMCOT, Inc. as ACSI II. He operates ACSI II out of the same building as ACSI; he employs the same employees as ACSI; he uses the same logo as ACSI; and he uses the same customer and supplier lists as ACSI. His

use of the ACSI II name is a way to continue operating as ACSI without ACSI's crippling liability to Copaco.

121. Billie Wayne Spradling Jr. makes self-serving and inaccurate representations regarding his financial situation. In negotiating a compromise with the IRS, he represented to the IRS that he owed \$250,000 to Mary Jo, and that he was liable for millions of dollars of debt to Copaco. His debt to Mary Jo was at most \$180,000, which, as noted above, he testified here had been forgiven by Mary Jo. With respect to his liability to Copaco, he testified to this court that he never believed that he owed Copaco anything; he said his representation to the IRS was based on counsel's advice. He told Copaco throughout 2001 that he had no ability to pay his debt, despite realizing a large profit from ACSI-II (*see* Finding 35).

122. Billie Wayne Spradling Jr. had \$18,000 in gambling losses in 2000; he bought his girlfriend an \$18,000 ring in 2001; and he paid \$15,000 on his girlfriend's car in 2001 – all the while representing to Copaco that he had no money with which to attempt repayment. In addition, he testified at his deposition that he was neither the beneficiary, settlor, or trustee of any trusts. Yet the evidence reveals the existence of several trusts, including the Spradling Residential Trust, and the Kelsey Dee Spradling 2000 Trust, of which he is the settlor.

123. Billie Wayne Spradling Jr. prefers some creditors over others. He paid \$50,000 to his father in 2001 in repayment of a loan, while making no effort to pay other creditors.

124. Billie Wayne Spradling Jr. has defaulted on more than \$8 million of debt owed to several creditors, representing more than 90% of his debt and more than 50% of his creditors. Billie Wayne Spradling Jr. misrepresents his financial condition depending on the expediency of the situation.

He repays some creditors, such as his father and Monte Mount, in preference to others. Billie Wayne Spradling Jr. attempts to place his assets out of the reach of creditors, by transferring them to trusts, to his family members, or into newly formed entities.

125. Billie Wayne Spradling Jr. was not generally paying his debts as they became due on the date of filing.

126. Each of the Alleged Debtors is generally not paying its/his debts as such debts become due. The magnitude of their debt to Copaco, the materiality of nonpayment, and Alleged Debtors' overall conduct in their financial affairs, compel the conclusion that, whether or not they have defaulted on debts other than Copaco's, Alleged Debtors are not, within the meaning of section 303(h), generally paying their debts as such become due. Each of Alleged Debtors' defaults to creditors other than Copaco reinforces the court's conclusions.

Special Circumstances Exception

127. Copaco contends that even if it fails to establish one of the elements of section 303 – i.e. that there is a contingency as to liability or a bona fide dispute – it nevertheless satisfied the 'special circumstances' exception to the technical requirements of section 303. Cases from this District recognize the special circumstances exception when it is shown that the debtor committed trick, fraud, artifice, or scam. *See In re Moss*, 249 B.R. 411, 424 (Bankr. N.D. Tex. 2000); *In re Norriss Bros. Lumber Co. Inc.*, 133 B.R. 599, 608-609 (Bankr. N.D. Tex. 1991). Though the court finds that each of the Alleged Debtors' conduct would warrant a finding of special circumstances, the court, having found that all elements of section 303 have been satisfied, need not elaborate further on the 'special circumstances'.

Conclusion

128. Upon the foregoing findings and conclusions, the court concludes that, in accordance with section 303(h) of the Code, relief under Chapter 7 should be ordered against Alleged Debtors.

129. If appropriate, these conclusions of law shall be considered findings of fact.

SIGNED: September 30, 2002.

ROBERT L. JONES
UNITED STATES BANKRUPTCY JUDGE